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TAGS: ECON, OECD
SUBJ: ECONOMIC POLICY COMMITTEE MARCH 6-7: MAIN ISSUES

REFS: (A) USOECD 4932
(B) USOECD 4991
(C) USOECD 4465
(D) USOECD 3914
(E) OECD DOCUMENTS CPE(75)1, 2, 3 AND 4

1. SUMMARY: EPC MEETING MARCH 6-7 WILL CONCENTRATE ON
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DOMESTIC MARCO-ECONOMIC DEVELOPMENTS AND POLICIES OF

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MAJOR SEVEN COUNTRIES. (SECRETARIAT'S PLANS FOR PROCE-
DURAL IMPROVEMENTS FOR THIS MEETING OUTLINED IN REF A.)
MAIN ISSUES FOR DISCUSSION WILL BE (A) PRESENT VIEWS OF
EOPC MEMBERS ON INFLATION/RECESSION TRADEOFF AND (B)
NATURE, SCALE AND TIMING OF RECOVERY POLICIES AT THIS
CONJUNCTURE. SECRETARIAT BELIEVES INFLATION OUTLOOK
HAS IMPROVED SUFFICIENTLY TO PERMIT EARLY REFLATIONARY
ACTION TO DEAL WITH WORSENING EMPLOYMENT SITUATION. IT
RECOMMENDS TAX CUTS, SUPPLEMENTARY PUBLIC EXPENDITURES,
INVESTMENT INCENTIVES AND RELAXATION OF MONETARY POLI-
CIES, BUT WITH PROVISO THAT SUCH MEASURES BE EASILY
REVERSIBLE IN EVENT OF TOO RAPID TURNAROUND. BALANCE-
OF-PAYMENTS ISSUES WILL LARGELY BE DISCUSSED AT WP-3
MEETING MARCH 5, BUT SECRETARIAT WOULD LIKE EPC TO CON-
SIDER WAYS OF REDUCING WIDE DIVERGENCES IN CURRENT
ACCOUNT BALANCES BETWEEN OECD COUNTRIES. IT SUGGESTS
THAT DIFFERENTIAL DEMAND MANAGEMENT WILL BE MORE EFFEC-
TIVE THAN CHANGES IN EXCHANGE RATES IN BRINGING ABOUT
EVENTUAL BP ADJUSTMENTS. ABOVE ISSUES WILL ALSO BE DIS-
CUSSED AT INFORMAL RESTRICTED MEETING EVENING MARCH 5
BY LARGE COUNTRY HEADS OF DELEGATION AND AT SUBSEQUENT
DINNER FOR THIS GROUP HOSTED BY AMBASSADOR TURNER.
(FACT THAT THESE RESTRICTED EVENTS TAKING PLACE SHOULD
NOT BE MADE KNOWN TO NON-PARTICIPATING COUNTRIES.) END
SUMMARY.

2. OUTLOOK FOR OECD ECONOMIES: SECRETARIAT'S DOCU-
MENTS FORESEE REAL GNP IN THE SEVEN MAJOR COUNTRIES
FALLING BY 3 PERCENT ANNUAL RATE IN FIRST HALF 1975,
FOLLOWED BY SLUGGISH RECOVERY IN SECOND HALF OF YEAR
BASED ON AUTONOMOUS HOUSING AND INVENTORY MOVEMENTS.
INFLATION EXPECTED TO DECELERATE THROUGHOUT 1975, BUT
YEAR-ON-YEAR RATE MAY STILL BE IN DOUBLE FIGURES.
DEMAND IN LABOR MARKETS CAN BE EXPECTED TO DETERIORATE
FURTHER IN 1975 WITH LITTLE CHANCE OF RECOVERY BEFORE
1976. SECRETARIAT BELIEVES BALANCE-OF-PAYMENTS OUTLOOK
FOR OECD AREA AS A WHOLE HAS IMPROVED OVER EARLIER FORE-
CASTS, BUT WIDE DIVERGENCES IN CURRENT ACCOUNT PER-
FORMANCE WILL REMAIN BETWEEN OECD COUNTRIES.

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3. MEETING OF SHORT-TERM ECONOMIC FORECASTERS FEBRUARY
27-28 (TO BE REPORTED SEPARATELY) INDICATED THAT IN THE
THREE WEEKS SINCE ABOVE FORECASTS WERE FINALIZED
SECRETARIAT VIEWS HAVE CHANGED SLIGHTLY FROM THOSE GIVEN
IN EPC DOCUMENTS. THEY NOW EXPECT THAT FIRST HALF GNP
FIGURES MAY BE EVEN WEAKER AND UNEMPLOYMENT LEVELS STILL
HIGHER, WHILE INFLATION RATE MAY DECELERATE MORE RAPIDLY
AS WAGE DEMANDS BECOME INCREASINGLY RESPONSIVE TO WEAK

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EMPLOYMENT OUTLOOK AND COMMODITY PRICES RESPOND TO DEPRESSED STATE OF WORLD ECONOMY. QUESTION FOR EPC DELS IS WHETHER MODEST RECOVERY WILL TAKE PLACE IN SECOND HALF AND WHETHER IT WILL CONTINUE AND STRENGTHEN INTO 1976.

4. POLICY ISSUES: SECRETARIAT ASKS EPC TO FOCUS ATTENTION ON PRESENT CONJUNCTURAL TRADE-OFF BETWEEN INFLATION AND UNEMPLOYMENT. IN PARTICULAR, CAN COUNTRIES NOW AFFORD TO RESTORE SUBSTANTIAL RATE OF GROWTH OR DOES CONTINUING INFLATION MAKE THIS TOO RISKY? SECRETARIAT NOTES THAT RATE OF WAGE INCREASES IN OECD AREA IS STILL VERY HIGH AND INFLATION RATE MAY REMAIN CLOSE TO 10 PEFCENT IN 1975. HOWEVER, IT ARGUES THAT EVEN IF STEPS ARE TAKEN TO REVIVE ACTIVITY, SLACK DEMAND WILL PERSIST FOR MOST OF 1975, SO THAT UPWARD PRESSURE ON PRICES WILL BE SUBSTANTIALLY REDUCED. IN FACT, SECRETARIAT SEES DANGER IN ULTRA-CAUTIOUS POLICIES, SINCE BY ALLOWING UNEMPLOYMENT TO GO ON RISING MASSIVELY, PENT UP POLITICAL AND SOCIAL PRESSURES MAY FORCE COUNTRIES EVENTUALLY TO TAKE VERY STRONG REFLATIONARY MEASURES AND THUS RUN GREATER RISK OF SETTING OFF NEW INFLATIONARY SPIRAL. SECRETARIAT PROPOSES THAT EPC DISCUSS NATURE, SCALE AND TIMING OF RECOVERY POLICIES. IT ALSO ARGUES THAT THERE IS NEED FOR FREQUENT INTER-GOVERNMENTAL CONSULTATIONS TO ALLOW COUNTRIES TO REGULATE THEIR DOMESTIC DEMAND IN THE CONTEXT OF HAVING IMPROVED KNOWLEDGE OF EXPECTED TRANSMISSION EFFECTS TO AND FROM OTHER COUNTRIES.

5. SECRETARIAT INVITES EPC TO EXPRESS VIEWS ON DESIRABLE STANCE AND TIMING OF POLICY IN EACH OF MAJOR SEVEN COUNTRIES. IT BELIEVES THAT COUNTRIES IN STRONG EXTERNAL POSITION SHOULD LEAD WAY BY TAKING EXPANSIONARY
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MEASURES, NOT SOLELY IN INTEREST OF BALANCE-OF-PAYMENTS ADJUSTMENT PROCESS BUT MAINLY TO REDUCE RISKS OF SERIOUS WORLD RECESSION. THUS, THE SECRETARIAT BELEIVES IT WAS APPROPRIATE FOR GERMANY TO HAVE BEEN FIRST MAJOR COUNTRY TO CHANGE COURSE, AND SUGGESTS THAT U.S. SHOULD PROMPTLY PUT IMPORTANT EXPANSIONARY MEASURES INTO EFFECT SINCE ITS ECONOMY IS BOTH LARGEST AND MOST DEPRESSED AMONG MAJOR SEVEN COUNTRIES. JAPAN ALSO SHOULD UNDERTAKE REFLATIONARY ACTION AFTER SPRING WAGE-ROUND IS COMPLEATED. COUNTRIES WITH EXTERNAL DEFICITS AND VERY RAPID INFLATION, SUCH AS UK AND ITALY, SHOULD CONCENTRATE ON CONTROLLING INFLATION AND IDEALLY RECEIVE STIMULUS TO THEIR ECONOMIES FROM OUTSIDE RATHER THAN FROM DOMESTIC SPENDING.

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6. POLICY INSTRUMENTS: SECRETARIAT PROPOSES THAT EPC DISCUSS ALTERNATIVE POLICY MEASURES WHICH MIGHT BE USED TO STIMULATE ACTIVITY. IT BELEIVES THESE SHOULD BE QUICK ACTING AND EASILY REVERSIBLE IN CASE SUBSEQUENT UPSWING APPEARS LIKELY TO CREATE RISK OF FURTHER INFLATION. SECRETARIAT SUGGESTS THAT TAX REDUCTIONS BY ELIMINATION OF FISCAL DRAG FROM INCOME TAXES, CUTS IN INDIRECT TAXES OR MEASURES TO IMPROVE CORPORATE CASH FLOW WOULD BE APPROPRIATE, AND IN SOME COUNTRIES MIGHT PROVIDE SCOPE FOR ENCOURAGING LOWER WAGE DEMANS. PUBLIC EXPENDITURE PROGRAMS SHOULD ALSO BE CONSIDERED IF THEY CAN BE SWIFTLY EMPLOYED. MONETARY POLICY SHOULD ENTER PERIOD OF PRONOUNCED RELAXATION SINCE, WITH REAL INCOME, PROFIT AND DEMAND EXPECTATIONS NOW DEPRESSED,

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INTEREST RATES MAY HAVE TO FALL SUBSTANTIALLY TO BRING REVIVAL IN CONSUMER SPENDING AND BUSINESS INVESTMENT. HOWEVER, SUCH RELAXATION SHOULD BE BRIEF AND FOLLOWED BY MORE NEUTRAL POSTURE TO AVOID EXCESSIVE LIQUIDITY BUILDUP WITH MEDIUM-TERM INFLATIONARY DANGERS.

7. BALANCE OF PAYMENTS: SECRETARIAT CONSIDERS IT LIKELY THAT OPEC SURPLUS WILL DIMINISH OVER NEXT FEW YEARS AND THAT OECD AREA MAY BE BACK IN CURRENT ACCOUNT BALANCE BY OR BEFORE 1980. PROJECTIONS FOR OECD'S OVER-ALL CURRENT ACCOUNT DEFICIT IN 1975 HAVE BEEN REDUCED FROM EARLIER FORECASTS TO $28 BILLION, BUT BENEFIT MUCH FROM THIS IMPROVED OUTLOOK. IN ADDITION, ABOUT 60 PERCENT OF TOTAL FORECAST DIFICIT WILL FALL ON SMALLER OECD COUNTRIES. SECRETARIAT NOTES THAT WHILE TOTAL OECD CURRENT DEFICIT MAY BE EXPECTED TO DECLINE RAPIDLY, PRESENT PATTERN OF PAYMENTS IMBALANCES MAY PERSIST AS BETWEEN OECD COUNTRIES.

8. BP ADJUSTMENT POLICIES: ALTHOUGH MAIN DISCUSSION OF EXTERNAL POLICIES WILL TAKE PLACE IN WP-3 ON DAY PRECEDING EPC, NEVERTHELESS EPC DELS WILL BE ASKED TO EXCHANGE VIEWS ON ADJUSTMENT POLICIES THAT MIGHT BE PURSUED. SECRETARIAT DOES NOT CONSIDER EXCHANGE RATE CHANGES TO BE VERY SATISFACTORY MEANS OF ADJUSTMENT IN PRESENT CIRCUMSTANCES OF STAGNANT WORLD TRADE AND CONTINUING DIVERGENCE IN RATES OF INFLATION. COUNTRIES IN STRONG BALANCE-OF-PAYMENTS POSITION HAVE BEEN GREATLY HELPED IN SLOWING THEIR INFLATION RATES BY APPRECIATION OF THEIR CURRENCIES, WHILE DEPRECIATION HAS CONSIDERABLY AGGRAVATED SEVERE INFLATION PREVAILING IN SOME DEFICIT COUNTRIES. SECRETARIAT FEELS THAT EVENTUAL ADJUSTMENT SHOULD COME FROM DIFFERENTIAL DEMAND MANAGEMENT WHICH WOULD PRESUMABLY REQUIRE EXPANSION IN STRONG COUNTRIES SUFFICIENT TO ENABLE WEAKER COUNTRIES TO HOLD BACK ON DOMESTIC DEMANS WITHOUT HAVING TO FOREGO GROWTH ALTOGETHER. IT ALSO IMPLIES STRONG EFFORTS BY DEFICIT COUNTRIES TO CONTROL DOMESTIC INFLATION SO AS TO IMPROVE COMPETITIVE POSITION ON WORLD MARKET.

9. UNITED STATES OUTLOOK AND POLICIES: SECRETARIAT

CONSIDERS QUESTION OF U.S. POLICY CHOICES TO BE MOST

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CRUCIAL OF ALL ISSUES UNDER DISCUSSION BY EPC. IT FULLY RECOGNIZES DIFFICULT TASK OF ARRESTING AND REVERSING PRESENT DECLINE IN ACTIVITY WHILE CONTINUING EFFORTS TO REDUCE INFLATION. HOWEVER, IT SUGGESTS THAT THERE MAY BE GREATER SCOPE FOR REFLATIONARY ACTION AS INFLATION RATE CONTINUES TO FALL IN RESPONSE TO WEAKNESS OF ACTIVITY THROUGH 1975. SECRETARIAT CONSIDERS ADMINISTRATION'S PRESENT PROGRAM, COMBINED WITH EXPECTED AUTONOMOUS REVERSALS IN HOUSEBUILDING AND INVENTORY DOWNTURNS, TO BE SUFFICIENT TO ARREST PRESENT DECLINE BUT NOT ENOUGH TO PRODUCE SUSTAINABLE RECOVERY. IT BELIEVES FURTHER QUICK AND SIZEABLE MEASURES WILL BE NEEDED, BUT WARNS THAT THESE SHOULD BE TEMPORARY AND EASILY REVERSIBLE IN VIEW OF RISK OF RE-ACCELERATION OF WAGE DEMANDS WHEN LABOR MARKET CONDITIONS IMPROVE.

10. JAPANESE OUTLOOK AND POLICIES: SECRETARIAT NOTES THAT UNDERLYING DEMAND TRENDS HAVE BECOME EVEN MORE SLUGGISH WHILE INFLATIONARY PRESSURES HAVE EASED CONSIDERABLY IN RECENT MONTHS, AND IT BELIEVES SOME MAJOR RELAXATION OF PRESENT DEMAND RESTRAINT WILL BE NEEDED IMMEDIATELY AFTER SPRING WAGE ROUND. JAPANESE DELEGATE TO SHORT-TERM FORECASTERS MEETING STRONGLY IMPLIED THAT HIS GOVERNMENT WOULD CONTINUE TO RELAX ITS POLICY STANCE, AND AGREED THAT OFFICIAL GOJ FORECAST OF 3-3.5 PERCENT REAL GROWTH OF GNP ASSUMED CHANGES IN PRESENT POLICY.

1. GERMAN OUTLOOK AND POLICIES: SECRETARIAT MAKES CLEAR ITS VIEW THAT "COUNTRIES LIKE GERMANY WHICH CAN AFFORD TO DO SO SHOULD TAKE MEASURES TO ENSURE QUICK RECOVERY OF DOMESTIC DEMANS." IT CONSIDERS GERMANY'S TARGET FORECASTS OF 2 PERCENT REAL GNP GROWTH AND UNDER 3 PERCENT UNEMPLOYMENT TO BE UNATTAINABLE WITHOUT ADDITIONAL STIMULATORY MEASURES.

12. EPC WILL BE ASKED TO APROVE UP-4 CHAIRMAN'S REPORT (CPE(75)4) AND WP-2 STUDY ON MACRO-ECONOMIC IMPACT OF HIGHER ENERGY PRICES OVER MEDIUM TERM (CPE(75)3). THESE TWO DOCUMENTS UNLIKELY TO ELICT
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MUCH COMMENT IN VIEW OF EXTENSIVE DISCUSSION IN WORKING PARTIES THEMSELVES AND SUBSEQUENT CIRCULATION OF DOCS TO CAPITALS FOR COMMENTS.
TURNER

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